STATE OF MAINE
PUBLIC UTILITIES COMMISSION

Docket No. 99-851

June 20, 2000

MAINE PUBLIC UTILITIES COMMISSION
Investigation into Bell Atlantic-Maine's Alternative Form of Regulation

ORDER DENYING OPA REQUEST FOR REVENUE REQUIREMENT CASE

WELCH, Chairman; NUGENT and DIAMOND, Commissioners

I. INTRODUCTION

In this Order we deny the request of the Office of the Public Advocate (OPA) to commence a revenue requirements proceeding for Bell Atlantic-Maine (BA-ME or the Company), and we explain our reasons for denying the request. We plan to issue shortly a separate Further Notice of Investigation in this docket that will describe our proposal for continuing the Alternative Form Of Regulation (AFOR) for BA-ME.

II. BACKGROUND AND POSITIONS OF THE PARTIES

On March 10, 2000, the OPA filed a Motion to Commence Rate and Revenue Investigation of BA-ME. The Public Advocate states in its Motion that the AFOR statute, 35-A M.R.S.A. § 9103(1), mandates that residential and small business ratepayers not be required to pay more for local telephone service as a result of the implementation of an AFOR than they would under traditional rate-base rate of return regulation. The OPA asserts that for the Commission to comply with the requirement, it must first determine what level of prices or revenues those ratepayers would be required to pay for local service under traditional rate-of-return regulation. Thus, the OPA asks that a rate case be initiated for the Company.

The Public Advocate states that the Commission must conduct an earnings investigation to establish a fair starting point if it continues or modifies the current incentive mechanism, and it must certainly conduct such a proceeding if a new AFOR is implemented. The OPA claims that an examination of the level of rates that BA-ME would charge under rate-of-return regulation is particularly applicable in this case, because during the five years that the AFOR has been in effect, the rates for local phone service have increased several times.

One specific area that the OPA argues must be examined is the level of savings generated by the Bell Atlantic/NYNEX merger. The OPA believes that the Commission must now apportion the savings between the Company and its ratepayers. The OPA asserts that the merger has produced cost savings, and the Commission indicated in its approval of the merger that it would consider the sharing of any savings at the time of the AFOR review.

The Public Advocate further asserts that the Commission must analyze the actual performance of the current AFOR mechanism. The OPA states that the Commission has nearly five years of experience with the AFOR, and a rate case is necessary to evaluate whether the AFOR has met the criteria of 35-A M.R.S.A. 9103 (1). The OPA also states that the AFOR statute requires that all legislative mandates must still be carried out under the AFOR; one of those mandates is contained in Title 35-A § 7303, which is sometimes referred to as the "local measured service" (LMS) statute. One requirement of that section is that local rates be maintained at as low a cost as possible, and the OPA asserts that an earnings investigation is necessary to determine if that mandate is being carried out.

Finally, the OPA asserts that the Commission is compelled to conduct a rate case by 35-A M.R.S.A. §9103(1), which requires that rates paid by residential and small business customers be no higher under an AFOR than they would be under traditional rate of return regulation. The OPA points out that basic rates have actually increased for several reasons over the past five years: 1) a $3.50 increase that was designed to partially offset the Company's revenue loss associated with access rate reform; 2) several increases associated with new Basic Service Calling Area (BSCA) routes; 3) an E-911 surcharge; and 4) a surcharge to cover the cost of Local Number Portability (LNP). Therefore, according to the OPA, the Company has been allowed to allocate all productivity gains to its more elastic services through rate decreases, while basic ratepayers have seen only increases. The OPA argues that Section 9103 requires that there be some relationship between prices and costs, and only a full earnings investigation can bring that about.

Bell Atlantic responded to the OPA motion by asserting that the OPA had misread the legislative directive contained in the AFOR statute. The Company says that the proper comparison should be between current rates and those that would be in effect had BA-ME *remained* under traditional ROR regulation, not with rates charged should it *return* to ROR regulation. Therefore, a cost of service investigation would provide little evidence of whether the statutory objectives of the AFOR have been satisfied. Other factors are far more probative, according to the Company.

Bell Atlantic also disputes the OPA claim that the Commission promised to return some portion of the Bell Atlantic/NYNEX merger savings to ratepayers. The Company asserts that while the Commission stated it would examine the merger savings and return some portion to customers, the timing and mechanism for that return were not specified. BA-ME argues that a rate case proceeding is not necessary to determine if ratepayers have realized an appropriate share of any merger savings. The Company suggests three alternatives by which any merger benefits could be shared with ratepayers: 1) through rate reductions made in response to competition, 2) by prospective adjustments to the productivity offset made in any extension of the AFOR term, or 3) by imputing such savings, even if they fail to materialize, in a rate case proceeding.

Finally, the Company disputes the OPA claims that the local rate increases that occurred during the AFOR benefited only the Company, while any decreases were applied only to more elastic services. The Company asserts that the increases to basic rates purportedly "enjoyed" by BA-ME were part of Commission-directed changes

specifically intended to reduce the Company's more elastic toll and carrier access revenues. The Company also points out that the LNP and E-911 surcharges are assessed on customers' bills by statutory directive, and are not a part of basic exchange rates. BA-ME says that even if a rate case were conducted, these surcharges would not be eliminated. For all these reasons, the Company concludes that the OPA motion should be denied.

The OPA submitted responsive comments to Bell's answer. In its response, OPA argued that even if the Commission has no obligation to examine the Company's costs and revenues, it should do so as a matter of public interest to ensure that the rates of BA-ME are reasonably in line with its costs. OPA argues that the Commission should at least examine three issues: 1) whether the 12.5% return on equity that was established at the start of the current AFOR is higher than a reasonable return would be in today's capital markets; 2) whether the 4.5% productivity factor that is used in the price index is an under-estimate of actual productivity gains; and 3) whether increasing sales and decreasing costs are resulting in substantial overearning by the Company.

The OPA also disputes the Company's assertion that the proper comparison should be between current rates and rates that would have been in place had BA-ME remained under ROR regulation. The OPA agrees that it would be impossible to directly compare current rates to those that would exist if the Company had continued under traditional regulation. The OPA argues that rates should be reset based on an examination of the Company's current cost and revenue structure.

The OPA asserts further that a rate proceeding is the only means by which the Commission will be able to fully reflect any savings resulting from the merger. Finally, the OPA argues that because a significant portion of the Company's business remains insulated from competition, it is not in the public interest to rely on voluntary rate reductions as the means of passing merger savings along to ratepayers.

The State Planning Office (SPO) has commented that examining the earnings of BA-ME is not a necessary or useful exercise, and that other matters concerning the regulation of the Company should take precedence. Specifically, SPO recommends that: 1) infrastructure deployment should be emphasized; 2) a benchmark for the introduction of technology and services should be established; 3) a fair, open and competitive market should be pursued, while moving towards retail and wholesale deregulation; and 4) the funding for the Schools and Libraries Network should be maintained.[1]

III. DISCUSSION AND ANALYSIS

The determination of whether to initiate a revenue requirements investigation must be addressed as part of the overall question of a future AFOR for Bell Atlantic. We must determine first whether the AFOR statute compels a revenue requirement rate investigation, and if there is no statutory requirement, whether we should undertake one

[1] We address the SPO recommendations more thoroughly in our companion order that sets forth the Commission proposal for establishing the prospective AFOR mechanism.

as a matter of public interest. The statute does not specifically require the Commission to conduct a rate case; rather, it requires the Commission to ensure consistency with the nine objectives stated in Section 9103.

The first of those objectives states that "ratepayers as a whole, and residential and small business customers in particular, may not be required to pay more for *local* telephone service as the result of … an [AFOR] than they would under traditional rate-base or rate-of-return regulation (emphasis added)." Although the Public Advocate urges that we conduct a revenue requirement proceeding, it simultaneously states that it is difficult, if not impossible, to determine what local rates for residential and small business customers would have been had we not adopted an AFOR for BA-ME. Bell Atlantic apparently agrees with this position. Among other problems, any attempt to establish BA's present revenue requirement on a cost-of-service basis is difficult because BA's present costs are "contaminated" by possible efficiencies it might have achieved pursuant to the incentives under the AFOR that it would not have achieved under continued ROR regulation.

We question, however, whether an historic comparison is directly relevant to the requirement of the statute, which states that customers cannot pay more for local telephone service under an AFOR than they "would" pay under ROR regulation. Ratemaking is generally a forward-looking exercise. In the first AFOR Order, *Public Utilities Commission, Investigation into Regulatory Alternatives for the New England Telephone and Telegraph Company d/b/a NYNEX,* Docket No. 94-123 (AFOR Order), we found that local service rates we were establishing under the AFOR would be no higher than they would be under ROR regulation. We believe the issue we must address in the current AFOR proceeding is the same. The question is whether a current revenue requirement proceeding will significantly aid us in making that determination.

A primary purpose of the 1995 AFOR was to encourage the Company to pursue efficiency gains, using any legitimate means of revenue enhancement or cost control. The AFOR sought to use the potential enhancement of Bell Atlantic's financial performance as an incentive for the company to pursue those efficiency gains while simultaneously protecting basic ratepayers through pricing rules. The AFOR also sought to maintain service quality at high historic levels, through rebates if those levels were not achieved, and to encourage the deployment of modern technology and services.

The OPA would have us interpret the statute to mean that the effects of any efficiency gains that the Company was able to achieve during the initial term of the AFOR should prospectively be returned to ratepayers through an earnings investigation. The OPA requests us to re-initialize rates based on the current relationship between the Company's costs and revenues, as well as on an analysis of what a reasonable rate of return would be under current capital market conditions.

We disagree with the OPA interpretation of the statute. Traditional revenue requirement rate cases have a tendency to undermine one of the basic purposes of incentive regulation: to break the link between costs and prices. A periodic resetting of rates to match costs, as under rate-of-return, cost-based regulation, sends a signal to a

utility that efficiency gains will be used to benefit ratepayers on a going-forward basis (or, conversely, if the utility is inefficient, that those excessive costs, if undetected by regulators, might serve as the basis for increased rates).

A revenue requirement proceeding can give us information about Bell Atlantic's total cost of service for all services. However, a revenue requirement proceeding tells us only the total cost of service and has only an indirect, if any, impact on rates for basic local service. Conducting a traditional revenue requirement case is not necessary for us to make the finding required by Section 9103(1), because that provision may be satisfied more directly through rate design. The statute requires only that rates for *local service* be no greater under an AFOR than they would be under rate-of-return regulation. We conclude that the mandate of 35-A M.R.S.A. § 9103(1) was met under the existing AFOR. The AFOR's pricing rules prohibited any increases to basic local service rates if the Price Regulation Index (PRI) was negative (as it has been throughout the AFOR). If the PRI for any prior year had been positive, any percentage increase to local service rates would have been limited to the percentage increase in the PRI. As discussed in greater detail below, the increases to local rates during the course of the AFOR occurred as a result of requirements entirely external to the AFOR. Under the AFOR itself, there were no increases to basic local service rates.

We discussed the meaning of 35-A M.R.S.A. § 9103(1) extensively in the first AFOR Order. We decided that the phrase "local telephone services" in section 9103(1) refers to basic local service and does not refer to long distance toll or other services. With regard to the comparison between rates for local service under ROR and AFOR regulation, we stated:

> Considering the statutory objective of section 9103 (1) as limited to basic service, we find that it its reasonably likely that rates under the AFOR price cap system we are adopting will be no higher than the levels that would occur under cost-based ROR regulation. Under the price limits we have chosen for basic rates, NYNEX may not increase basic rates by more than the overall price index (the price regulation index or PRI, that is equal to inflation less productivity, plus or minus exogenous changes), if the PRI is positive. If the overall index is equal to zero or is negative, NYNEX may not raise basic service rates at all, although it will not be required to lower them.
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> This pricing rule for basic rates is generally consistent with recent history.
> . . . .
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> The [last two rate] cases were decided after enactment of 35-A M.R.S.A. § 7303, which prohibits mandatory local measured service and requires the Commission to "preserve traditional flat rate local telephone service at as low a cost as possible . . . ." That section applies to traditional rate of return regulation, and 35-A M.R.S.A. § 9302 (sic 9102) specifically requires that it continue to apply under any

> AFOR. In our *Docket No. 92-130 Order,* we interpreted section 7303, ruling that it was possible to raise basic rates upon various circumstances each of which in effect amounts to a finding that an existing rate design is unreasonable and detrimental to overall rate levels or to the public interest. We listed four circumstances, all of them examples of detrimental rate design that might justify raising basic rates. We also recognized that the list was "not exhaustive" and that other circumstances might justify raising basic rates.

AFOR Order at 8-9.

The rationale of the AFOR Order for the pricing rule governing changes to the rates for local service was based to a great extent on 35-A M.R.S.A. § 7303. Section 9102 of the AFOR chapter states that an AFOR "must conform to the requirements of Chapter … 73" of Title 35-A. Thus, Section 9102 specifically applies section 7303 to any AFOR established pursuant to the AFOR statute. Section 7303 requires the Commission to "preserve traditional flat rate local telephone service at as low a cost as possible." In the AFOR Order, we ruled that, absent a rate design proceeding, there could be no justification for any substantial increase to basic local service rates under the AFOR (which served as a substitute for revenue-requirement proceedings rather than for rate design proceedings).

Based on this interpretation of sections 9103(1) and 7303, we established a pricing rule that applied to rates for local service (as well as other "core non-discretionary" services, including toll). Under the present AFOR, basic local service rates cannot increase unless the PRI is positive, and, if it is positive, those rates can increase by no more than the percentage change in the PRI. As indicated in the AFOR Order, Section 7303, as interpreted in Docket No. 92-130, applies with equal force to both rate of return and alternative forms of regulation. Without conducting a revenue requirement proceeding, we may make the finding required by 35-A M.R.S.A. § 9103(1) that local service rates under the revised AFOR will not exceed those that would be likely to occur under renewed rate of return regulation.

Put another way, our finding in the AFOR Order that the AFOR would produce rates no higher than would traditional regulation reflected two further conclusions. First, changes in the revenues and costs of Bell Atlantic would be unlikely, under traditional regulation, to justify <u>increases</u> in those rates absent significant inflation (hence the requirement that, where the PRI is negative, no increases are permitted). Second, because our experience with telephone rate design persuaded us that basic rates were generally <u>underpriced</u> relative to other services, even if a traditional rate case justified an <u>overall</u> reduction in rates, <u>these</u> rates-i.e. basic rates for residential customers-would not be reduced. Stated simply, Bell Atlantic's overall level of earnings-the sole product of a revenue requirements case-would not, under any plausible set of assumptions, influence the price level for these basic services.

In summary, the numerical results of a revenue requirement proceeding would not provide us with information that would be useful in determining whether the legal mandate contained Section 9103 (1) has been satisfied. At best, we would be able to

examine and analyze the current rate base, cost of capital, revenues and operating expenses of the Company. The level of each of those items may have been affected to some degree by the presence of the AFOR. Since local rates are a subset of all rates, and are established by allocating a portion of the overall revenue requirement, it follows that a revenue requirements case provides little useful information about future local service rates under ROR regulation versus under an AFOR.

While we agree with the OPA that we have the discretion to open an earnings investigation at this time, we decline to do so. We believe, as does the OPA, that competition is the best method of price and profit control, and in light of that fact, we think that using our limited resources is to issue the already established policy of encouraging the growth of competition for local service is likely to produce the greatest long-term benefits for Maine consumers.

The Public Advocate's recommendation that we conduct a rate case as a matter of discretion raises the question of whether, and to what extent, rates should be rebased in the change from one AFOR to another. As discussed earlier, rebasing rates to squeeze out earnings in excess of the allowed return arguably diminishes a major incentive of an AFOR, namely, the ability to retain the fruits of one's efforts to exceed the established productivity factor. On the other hand, it is questionable whether the incentive to attain greater efficiency will be lost if the utility is not allowed to continue to realize for the remainder of its regulated life whatever level of excess earnings it achieved under prior AFORs. Since, at the expiration of an AFOR, the utility has the right to seek relief if it is earning less than a fair return, it may be unfair to ratepayers to treat all overearning, no matter how great, as being permanently beyond the reach of the regulatory process.

We need not decide this issue in this case because we believe the development of competition will resolve the matter. As the Public Advocate correctly argues in his exceptions, competition is the most effective restraint on prices, with regulation being a necessary alternative only in its absence. We believe that competition is developing in the market for local telephone service, and of greater significance, there are steps, described in the FNOI to be issued shortly in this docket, that we intend to take to expedite that development. In simple terms, we see no reason to settle for a substitute when you can have the original, particularly since promoting competition is clearly the top priority of our nation's telecommunications regulatory policy. In a world of limited resources, we think it will maximize consumer welfare to expedite the advent of competition as opposed to engaging in what may be an extremely time consuming rate case, particularly one that could well involve Byzantine costs separations issues.

In reaching this conclusion, we are influenced by our belief that it is unlikely that BA is earning substantial excess returns. As explained elsewhere in this Order in our comparison of local rates under the AFOR and under traditional rate of return regulation, the pricing rules in the current AFOR (as well as those proposed in the FNOI) and a comparison of Maine's rates with those in other jurisdictions provide evidence that BA's level of earnings is (and will continue to be) within reasonable boundaries. Even if we had more doubts in this regard, however, we believe that competition is the remedy that will afford Maine's telephone users the greatest and most enduring benefits.

Inherent in our analysis is the proposition that if competition does not develop as rapidly as we anticipate, it may be necessary to reconsider the issue raised by the Public Advocate. We believe that will not be the case and expect that all of the interested parties will recognize that the rapid development of a truly competitive market for local service is in everyone's best interest.

The Public Advocate has stressed the fact that several basic rate increases occurred during the term of the AFOR. As explained below, those increases were not attributable to the operation of the AFOR. Even if they had been, it is not clear how a revenue requirements proceeding, as opposed to a more direct approach, would address that problem.

All of the increases to basic rates that occurred during the period of the AFOR took place outside of and notwithstanding the PRI formula and pricing rules of the AFOR. The major increase to basic rates that occurred during the initial term of the AFOR was entirely external to the AFOR, resulting from the enactment of legislation (35-A M.R.S.A. § 7101-B) that required the Commission to reduce access charges paid by interexchange carriers (IXCs) to Bell Atlantic and other local exchange carriers (LEC). The purpose of the legislation was to encourage IXCs (including Bell Atlantic and other ILECs and competitive LECs that provide interexchange service) to reduce their in-state long distance rates, which were relatively high compared to interstate long distance rates and to intrastate long distance rates in other states. The Commission was given authority to compel IXCs to pass through the access reduction if it found that effective competition did not exist in the in-state toll market.

This legislation was not contemplated when the AFOR was implemented. It was necessary for the Commission to implement the access rate reductions in a way that was consistent with other basic regulatory objectives. In Bell Atlantic's case, those objectives included an historic objective reaffirmed in the AFOR statute, i.e., allowing the utility a reasonable opportunity to earn a fair return on the investment necessary to provide telephone service. The Commission implemented the access reduction by accepting a stipulation offered by a broad range of the parties, including the Public Advocate, that participated in the proceeding initiated to consider the matter, Dockets # 94-123 (Reopened) and # 97-319. While basic rates were increased by $3.50 in three steps, the parties to the Stipulation estimated the decrease in the Company's revenues from the access charge reduction significantly exceeded the additional local service revenues generated.

By accepting the Stipulation, the Commission was able to preserve the letter and spirit of several statutory provisions that could be read to have contradictory or competing policy implications. In addition to sections 7101-B and 9103 of Title 35-A, discussed above, section 7101 sets forth general telecommunications policy for the State and, most importantly, Section 7303, as discussed above, requires the Commission to "preserve traditional flat rate local telephone service at as low a cost as possible." Section 7101-B, however, requires a specific reduction in access charges "notwithstanding any other provision of law." Section 7101-B therefore has priority over the policies of section 7303. The increase to basic local service rates that we ordered

pursuant to the access reduction stipulation did not occur as a result of the AFOR.[2] Indeed, it was necessary to waive the AFOR pricing rules (which do not permit any increase in basic rates when the PRI is negative) to allow those increases. Acceptance of the stipulation was a reasonable regulatory response to a legislative directive to reduce access charges. In fact, the presence of the AFOR may have mitigated the potential effect that reduced access charges had on the basic rates increase, because Bell Atlantic had some intrinsic incentive to preserve the essence of the AFOR by entering into a stipulated result, rather than expending resources on a rate case proceeding.

The other "basic rate increases" that the OPA mentions are also unrelated to the functioning of the AFOR. The E-911 surcharge was legislatively mandated and is merely collected by LECs as "agents" for the Emergency Services Communications Bureau, an agency of the State of Maine. The LNP surcharge is mandated by the FCC as a means of recovering the costs associated with allowing customers to retain their phone number, even if they switch to an alternative LEC. LNP is designed to encourage local competition. Neither of these surcharges would in any way be affected by a revenue requirements proceeding.

Finally, the OPA mentions that some local increases had occurred due to the implementation of new basic service calling areas pursuant to the BSCA Rule (Chapter 204). Here again, the AFOR played no part in these price adjustments. Two relatively small increases (each about $.40 per month) were implemented; one of these increases was temporary and has expired. The purpose of the increases was to compensate for up-front and ongoing costs associated with providing certain customers with expanded local calling areas, thus reducing their in-state toll bills.

The Public Advocate also points out that under the pricing rules of the current AFOR, the Company has been allowed to apply any price decreases required by changes in the PRI to its more elastic services. One of those pricing rules states that rates for non-discretionary core services (including both local and toll) may increase only up to any percentage increase in the Price Regulation Index (PRI). Because the PRI adjustment has been negative in each year of the current AFOR, basic rates have been effectively capped during that time. BA-ME has had the discretion to apply any required price reductions to services of its choice, and it has chosen to apply the decreases mainly to its more elastic services.

This is not an indication that basic rates would have been lower had we not implemented an AFOR. We cannot be certain what would have happened to local rates if the Company had been operating under traditional ROR regulation. As indicated above, however, we believe it is reasonably likely that if rate reductions were required, there would have been considerable pressure to reduce toll rates, particularly in light of the access rate mandate contained in 35-A M.R.S.A. §7101-B, and to either increase basic local service rates or leave them unchanged.

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[2]It would not have been economically possible to place increases that offset the access reductions on retail toll because of the close relationship between retail toll and access, which is a major component in the cost of providing toll.

As further evidence that the AFOR is likely to have been to the advantage of ratepayers, we can take administrative notice of certain data concerning price changes in the telecommunications industry as reported by the FCC in March of this year.

Under the AFOR, BA-ME prices have fallen by almost 10% overall: that is the significance of the PRI falling from 100 in 1995 to 90.69 in December of 1999 (which reflects prices in 2000). Viewing the period from 1995 to December of 1999 (to reflect prices in 1995 and through the first 11 months of 1999 to provide an apples to apples comparison with the annual data available from the FCC), the PRI has fallen by 6%, to 94.11. In other words, at the end of 1999 BA customers in Maine were paying less than 95 cents in nominal dollars for the same thing they paid $1 for in 1995.

Contrast this with the national averages reported by the FCC. Consumer prices for all telephone services increased by slightly over 3% from 1995 to 1999 (to an equivalent PRI of 103.02). Under the AFOR, for the period 1995-1999, customers in Maine beat the national average by almost 9%. Consumer prices for local residential services rose by over 6% from 1995 to 1999 (to an equivalent PRI of 106.12); and prices for intrastate toll services rose by almost 9% (to 108.93) over the same period. BA customers in Maine outdid even the performance of interstate toll customers, who benefited from very substantial reductions in interstate access, and who saw a reduction over the period of about 3% (to an equivalent PRI of 97.75).

Other data support our conclusion that the AFOR has served Maine customers well. First, according to FCC statistics, Maine has the second highest telephone penetration rate in the country, and our rate is particularly high, compared with the other states, for households earning less than $10,000 annually. At the end of 1999, 97.6% of all households in Maine and 94.5% of households with incomes under $10,000 had telephone service. While the use of outreach programs to increase awareness of our Lifeline and Linkup programs for qualifying low-income customers certainly deserves a fair share of the credit, in general our basic rates are affordable for the vast majority of the State's residents.

Further, the FCC recently ordered that Bell Atlantic receive about $10.7 million in additional high cost funds for 2000, based on a formula that considered the cost of local loops in each state. The results for Maine show that our loop costs exceed 135% (deemed the benchmark by the FCC) of the national average cost. Vermont and West Virginia are the only other Bell Atlantic states that will receive additional support under the FCC order (there are only 12 states in the country that will get additional funds). This suggests that from the consumers' view, the relationship of cost to price is quite favorable when compared to other jurisdictions.

These comparisons argue powerfully that Maine's ratepayers have done well under the AFOR, and it is unlikely – though not necessarily impossible – that a different

form of regulation would have achieved superior results.

Having concluded that the present AFOR complied with the mandate of section 9103(1), and that it may be satisfied in the future by a pricing rule similar to that of the present AFOR, we will now address some practical considerations that mitigate against a rate case proceeding.[3] Traditional rate cases must consider rate design in addition to determining a total revenue requirement, although none of the Bell Atlantic (formerly NYNEX) rate cases in the past 15 years has included a rate design based on any cost of service studies. Rather, rates in effect at the time of the rate case were used as the starting point for any rate adjustments. To the extent that a new rate case proceeding would address rate design, it must also consider the relationship between the Company's total allowed revenue and the prices that can be set for services other than basic local service.

First, as explained above, intrastate access charges must be set in accordance with 35-A M.R.S.A. § 7101-B. Those access rates were last changed in 1999, and they will be reset in 2001, as provided by the statute. Based on current interstate access rates, intrastate access rates would have to be reduced again in 2001, and it is possible that because of proposals currently before the FCC, interstate rates will be even lower than they are at present. Given that a full 9-month rate case would extend into 2001, it is reasonably certain that we will know the level of interstate access rates that we must mirror, and we would include them in any rate design process. Whatever the exact level, it is probable that intrastate access rates will have to be reduced on May 30, 2001. Given that scenario and the likely corresponding decrease in toll rates, we would be limited in the amount of revenue that we could project the Company would obtain from these sources. The total revenue projection would depend, of course, on the usage projected for access and toll services, but it appears that the total revenue generated from intrastate access and toll is likely to decline.

Further, Bell Atlantic has had flexibility under the AFOR in pricing its enhanced and advanced services, and it presumably has set the prices for those services at a level that maximize its revenues. Thus, in the rate design phase of a revenue requirement proceeding, we likely would not be able to project much additional revenue from enhanced or advanced services unless a significant increase in usage could be expected. Because of the legal and practical limitations involved in establishing rates for access, toll and enhanced and advanced services, we effectively would be forced to recover any remaining revenue requirement from basic local rates. Local rates would become the residual "basket" into which the remainder of the total requirement would be placed. The mandate of 35-A M.R.S.A. §7303 ("flat rate local telephone service at as

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[3]By declining to initiate a revenue requirement investigation, we do not address the issue of the disposition of the savings that NYNEX BA projected would occur as a result of the merger of Bell Atlantic and NYNEX. In a rate case proceeding, we could have explored this issue directly, because the effects of the merger are now an intrinsic part of the Company's financial picture. Since we have decided not to initiate a rate case, the effects of the merger, as well as the more important issue of how (if, at all) those effects should be reflected in the Company's rates, may be considered in the AFOR proceeding. We will address the issue in the Further Notice of Investigation to be issued shortly in that portion of this docket.

low a cost as possible") must give way to the access charge mandate of Section 7101-B ("Notwithstanding any other provision of law, …."). Thus, it is possible that the Company's overall revenue could be lower than the amount found reasonable in the last rate case, and basic local rates might have to be increased to permit the Company the opportunity to earn its allowed return.

From this discussion, we do not intend to imply that a traditional rate case should not be initiated simply because there is a chance that the most inelastic rates would have to be increased. Rather, we believe we should direct our resources toward modifying and improving the AFOR mechanism, as necessary to meet all of the objectives set forth in the AFOR statute. In short, we find that we can best meet the goals of telecommunications policy for the State of Maine, as established in 35-A M.R.S.A. § 7101, by concentrating on the design of the future AFOR and encouraging the growth of competition, rather than by conducting a revenue requirement proceeding.

IV. CONCLUSION

Based on the analysis contained in this order, we conclude that a revenue requirement investigation should not be initiated for Bell Atlantic-Maine at this time. We find that the AFOR statute does not require a revenue requirements proceeding, and regulatory policy considerations lead us to conclude that an earnings investigation is not warranted.

Dated at Augusta, Maine, this 20th day of June, 2000.

BY ORDER OF THE COMMISSION

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Dennis L. Keschl
Administrative Director

COMMISSIONERS VOTING FOR: Welch
Nugent
Diamond

NOTICE OF RIGHTS TO REVIEW OR APPEAL

5 M.R.S.A. § 9061 requires the Public Utilities Commission to give each party to an adjudicatory proceeding written notice of the party's rights to review or appeal of its decision made at the conclusion of the adjudicatory proceeding. The methods of review or appeal of PUC decisions at the conclusion of an adjudicatory proceeding are as follows:

1. Reconsideration of the Commission's Order may be requested under Section 1004 of the Commission's Rules of Practice and Procedure (65-407 C.M.R.110) within 20 days of the date of the Order by filing a petition with the Commission stating the grounds upon which reconsideration is sought.

2. Appeal of a final decision of the Commission may be taken to the Law Court by filing, within 30 days of the date of the Order, a Notice of Appeal with the Administrative Director of the Commission, pursuant to 35-A M.R.S.A. § 1320(1)-(4) and the Maine Rules of Civil Procedure, Rule 73, et seq.

3. Additional court review of constitutional issues or issues involving the justness or reasonableness of rates may be had by the filing of an appeal with the Law Court, pursuant to 35-A M.R.S.A. § 1320(5).

Note: The attachment of this Notice to a document does not indicate the Commission's view that the particular document may be subject to review or appeal. Similarly, the failure of the Commission to attach a copy of this Notice to a document does not indicate the Commission's view that the document is not subject to review or appeal.